No. 20,621

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOHN M. ROGERS and JOHN M. ROGERS, Executor of the Estate of GLADYS B. ROGERS, deceased,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The findings of fact and opinion of the Tax Court (IB-R. 144-164)[1] are reported at 44 T.C. 126.

JURISDICTION

The petition for review (IB-R. 169-173) involves individual income taxes for the year 1958. On June 28, 1963, the Commissioner of Internal Revenue mailed to the taxpayers a notice of a deficiency in income taxes for the year 1958 in the total amount of $111,707.80.

1/ "IA-R." and "IB-R." references are to Volumes A and B of the record on appeal. "II-R." references are to Volume II of the record on appeal.

(IA-R. 7-14.) Within 90 days thereafter, on August 19, 1963, the taxpayers filed a petition with the Tax Court for a redetermination of the deficiency under the provisions of Section 6213 of the Internal Revenue Code of 1954. (IA-R. 1-5.) The decision of the Tax Court was entered July 26, 1965. (IB-R. 164a-164b.) The case is brought to this Court by a petition for review filed October 18, 1965 (IB-R. 169-173), within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of that Code.

QUESTION PRESENTED

Whether the Tax Court correctly held that, where the taxpayers granted an option to purchase their property to Standard Oil of California and the option was exercised, the taxpayers sold their property to Standard Oil pursuant to the option and used the proceeds therefrom to purchase similar property from a third party and therefore--contrary to the taxpayers' position--did not effect an exchange of property upon which gain or loss would not be recognized pursuant to Section 1031 of the Internal Revenue Code of 1954.

STATUTE INVOLVED

Internal Revenue Code of 1954:

> SEC. 1001. DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS.
>
> (a) Computation of Gain or Loss.--The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in

section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) Amount Realized.--The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * *

(26 U.S.C. 1958 ed., Sec. 1001.)

SEC. 1002. RECOGNITION OF GAIN OR LOSS.

Except as otherwise provided in this subtitle, on the sale or exchange of property the entire amount of the gain or loss, determined under section 1001, shall be recognized.

(26 U.S.C. 1958 ed., Sec. 1002.)

SEC. 1031. EXCHANGE OF PROPERTY HELD FOR PRODUCTIVE USE OR INVESTMENT.

(a) Nonrecognition of Gain or Loss From Exchanges Solely in Kind.--No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(b) Gain From Exchanges Not Solely in Kind.--If an exchange would be within the provisions of subsection (a), of section 1035 (a), or of section 1036 (a), if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(c) Loss From Exchanges Not Solely in Kind.--If an exchange would be within the provisions of subsection (a), of section 1035 (a), or of section 1036 (a), if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain or loss, but also of other

property or money, then no loss from the exchange shall be recognized.

(d) [As amended by Sec. 44(a) and (b), Technical Amendments Act of 1958, P. L. 85-866, 72 Stat. 1606] Basis.--If property was acquired on an exchange described in this section, section 1035(a), or section 1036(a), then the basis shall be the same as that of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized on such exchange. If the property so acquired consisted in part of the type of property permitted by this section, section 1035 (a), or section 1036(a), to be received without the recognition of gain or loss, and in part of other property, the basis provided in this subsection shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. For purposes of this section, section 1035 (a), and section 1036 (a), where as part of the consideration to the taxpayer another party to the exchange assumed a liability of the taxpayer or acquired from the taxpayer property subject to a liability, such assumption or acquisition (in the amount of the liability) shall be considered as money received by the taxpayer on the exchange.

(26 U.S.C. 1958 ed., Sec. 1031.)

STATEMENT

During the year 1958, the taxpayers, John M. Rogers and Gladys B. Rogers, now deceased,[2/] resided at Walnut Creek, California. They filed a joint federal income tax return on the cash method for that year. (IB-R. 145; see Ex. 1-A, IA-R. 28-46.)

2/ For convenience, the term "taxpayers" herein refers to John M. Rogers and Gladys B. Rogers, although upon her death her estate was substituted as a party to this case.

Late in 1955 the taxpayer John M. Rogers retired from his position as an executive of a large international engineering construction organization and thereafter was concerned with securing investment income. In April, 1956, the taxpayers acquired for investment an office building situated at 571 Market Street, San Francisco, California (hereinafter referred to as 571 Market Street), and thereafter held such property for the income derived from rents and profits. Coldwell, Banker & Company, a San Francisco real estate firm which had been instrumental in the sale of the property to taxpayers, performed for a fee the various duties associated with the management of the building. (IB-R. 145-146.)

The Standard Oil Company of California (hereinafter referred to as Standard Oil) desired to acquire five adjoing properties, including 571 Market Street, as the site for a proposed new office building, and prior to August 22, 1957, commissioned Buckbee Thorne & Company, a San Francisco real estate firm (hereinafter referred to as Buckbee Thorne) to negotiate for the purchase of such five properties on behalf of Standard Oil as undisclosed principal. Since Standard Oil wished to remain an undisclosed principal until all five properties had been assembled, Buckbee Thorne, with the authorization of Standard Oil, named California Pacific Title Insurance Company (hereinafter referred to as the title company) to acquire title for its principal. (IB-R. 146.)

During August, 1957, the taxpayers were approached by a representative of Buckbee Thorne who desired to obtain an option to purchase 571 Market Street. They advised such representative that they would sell for a price of $750,000 plus the real estate commission, and on August 13, 1957, an escrow account (numbered 462011) was opened at the title company under the name "Buckbee Thorne-Rogers." (IB-R. 146.)

On August 22, 1957, the taxpayers granted to the title company an option to purchase 571 Market Street. (IB-R. 146; see Exs. 4-D, 5-E, IB-R. 75-76, 77.)[3/] The option agreement provides in pertinent part as follows (IB-R. 147; Ex. 4-D, IB-R. 75-76):

> For and in consideration of the sum of SEVEN THOUSAND SEVEN HUNDRED AND TWELVE AND 50/100 ($7,712.50) Dollars to seller in hand paid, the receipt of which is hereby acknowledged by said seller, to apply on the purchase price, the undersigned JOHN M. ROGERS and GLADYS B. ROGERS herein designated as the seller, hereby grants the right and option to purchase and agrees to sell to CALIFORNIA PACIFIC TITLE INSURANCE COMPANY herein designated as the purchaser, or its assigns, at any time within 120 days from the date hereof, the following described property in the City and County of San Francisco, State of California, to wit: * * *
>
> [here follows description of 571 Market Street]
>
> For the purchase price of SEVEN HUNDRED SEVENTY ONE THOUSAND TWO HUNDRED FIFTY AND 00/100 ($771,250.00) Dollars lawful money of the United States of America, payable as follows: CASH
>
> * * * *

3/ The option agreement was recorded on December 18, 1957. (IA-R. 20.)

> If said purchaser elects to purchase said property at the price and on the terms herein set forth, and within the time specified, the said purchaser shall give said seller due notice in writing and shall pay an additional sum of $69,412.50 for account of said seller to Buckbee Thorne & Co. * * * said sum to apply on the purchase price * * *.

By letter dated August 30, 1957, Buckbee Thorne transmitted to the title company the option granted by the taxpayers to the title company as well as options for the other properties Standard Oil was seeking to acquire. (IB-R. 147; Ex. 6-F, IB-R. 78.)

The taxpayers then advised Coldwell, Banker & Company, as managers of their property, that they had entered into the option for the sale of 571 Market Street. (IB-R. 147.)

In mid-September, 1957, the taxpayers were approached by Coldwell, Banker & Company, acting as agents for the owners of an office building known as the Sharon Building, with the suggestion that the Sharon Building might be purchased for $1,200,000, and that the proceeds from the sale of 571 Market Street might be used for such purpose. Prior to that time, the taxpayers were not aware that the Sharon Building was for sale. They advised Coldwell, Banker & Company at that time that they were not interested in buying another piece of property, but rather that they intended to invest the proceeds from the sale of 571 Market Street in high grade stock. Coldwell, Banker & Company then suggested that if they did not wish to purchase the Sharon Building it was possible that an advantageous exchange of 571 Market Street for the Sharon Building could be made and that the taxpayers would receive a return on their investment which would be substantial and comparable to that which they were then receiving. The

taxpayers proposed an exchange in which the Sharon Building would be valued at $1,050,000 and 571 Market Street would be valued at its then option price of $771,250. This proposal was rejected, but the owners of the Sharon Building countered with an offer to value the Sharon Building at $1,150,000. (IB-R. 147-148.)

On November 25, 1957, the title company addressed a letter to Standard Oil requesting that the latter assume the obligation of holding the title company harmless on account of any loss it might sustain in making payments to tenants of properties to be acquired in order to secure early terminations of such leases. Standard Oil so agreed. (IB-R. 148; Ex. 7-G, IB-R. 79.)

The taxpayers executed a document entitled "Agreement to Exchange" dated December 2, 1957. That document does not bear any other signatures. It recites that the taxpayers agreed to exchange 571 Market Street for the Sharon Building. It further provided that 571 Market Street should be transferred subject to existing leases and "subject to existing option to sell, which obligation is to be assumed by the owners" of the Sharon Building. It further provided that coincident with the exchange of deeds to the two properties the taxpayers agreed to pay the owners of the Sharon Building $400,000 in cash, and that "This offer is made subject to Coldwell, Banker & Company securing a loan on the Sharon Building in the sum of at least $600,000", with interest, installment payments, and other terms satisfactory to the taxpayers. (IB-R. 148-149; Ex. 39, IB-R. 142-143; see also II-R. 29-31.)

On December 6, 1957, the taxpayers left the above document with Coldwell, Banker & Company. On the same date an escrow account (numbered 463529) was opened at the title company under the name "Sharon--Coldwell Banker & Co." (IB-R. 149.)

On December 9, 1957, the taxpayer John M. Rogers addressed a letter to the title company advising that he had entered into an agreement with the twelve owners of the Sharon Building to exchange 571 Market Street, subject to the outstanding option, for the Sharon Building. (IB-R. 149; Ex. 8-H, IB-R. 80-81.)

On December 9, 1957, the title company issued a preliminary title report concerning the Sharon Building and delivered it to the taxpayers. (IB-R. 149; Ex. 9-I, IB-R. 82-83.)

On December 16, 1957, Buckbee Thorne notified the title company that thereafter Standard Oil would issue instructions to the title company regarding the options. (IB-R. 149; Ex. 10-J, IB-R. 84.)

On December 16, 1957, the taxpayer John M. Rogers delivered to the title company his check for $7,712.50, which amount equalled the consideration previously paid to him and his wife for the option granted by them on August 22, 1957. The receipt given by the title company for such amount stated that such sum was to be applied on an exchange proration statement to be supplied by Coldwell, Banker & Company. (IB-R. 150; Ex. 11-K, IB-R. 85.)

On December 17, 1957, the taxpayers delivered to the title company a deed conveying 571 Market Street to the title company. At the same time the taxpayers gave written escrow instructions to the title company

"to deliver said deed to the order of Hurford C. Sharon, et al.," at such time as the title company had vested title to the Sharon Building in the taxpayers, the taxpayers have given the title company their promissory note in the amount of $550,000 payable to Aetna Life Insurance Company secured by a deed of trust on the Sharon property and the title company had in its possession the proceeds of a loan of $550,000 from such life insurance company. The title company was further instructed by the taxpayers to use the loan of $550,000 to pay off an existing mortgage on 571 Market Street held by Equitable Life Assurance Society, pay Hurford C. Sharon et al., the sum of $368,750, and to make other specified disbursements. (IB-R. 150; Exs. 12-L, 13-M, IB-R. 86-88.)

On December 18, 1957, Standard Oil delivered a letter of escrow instructions authorizing and directing the title company to record on December 18, 1957, the five options (including the option on 571 Market Street), to exercise such options on December 19, 1957, by sending notices to the respective property owners in care of Buckbee Thorne, to take title to the properties in its (the title company's) name, and then convey the five parcels of property to Standard Oil in one grant deed. In that letter, Standard Oil stated that it would at the same time deliver to Buckbee Thorne for the account of the respectiv owners the amounts which it had been agreed would be paid upon the exercise of the options (including $69,412.50 for the account of the taxpayers) and that it would issue to the title company a check for $2,344,537.50 to cover the remaining purchase price of all the five properties. (IB-R. 150-151; Ex. 14-N, IB-R. 89-96.)

On December 19, 1957, the title company addressed a letter, dated December 13, 1957, to the taxpayers in care of Buckbee Thorne, giving notice of the exercise of the option on 571 Market Street. At the same time the title company gave its check in the amount of $69,412.50 to Buckbee Thorne for the account of the taxpayers and furnished Buckbee Thorne a copy of the previously mentioned letter of December 9, 1957 (Ex. 8-H, IB-R. 80-81), addressed by the taxpayer John M. Rogers to the title company. On the same date, Standard Oil delivered to the title company its check for $2,344,537.50. (IB-R. 151; Exs. 15-0, 16-P, IB-R. 97-98.)

On December 20, 1957, Buckbee Thorne notified the taxpayers by telephone that the option had been exercised and that it had received from the title company its check for $69,412.50. On the same date, Buckbee Thorne addressed a letter to the taxpayers containing the same information and stating that the title company had requested that the check be returned to it to be held by it in connection with an exchange of 571 Market Street for the Sharon Building. In that letter Buckbee Thorne requested the taxpayers' approval to pay over the $69,412.50 to the title company for such purpose. On December 23, 1957, on a copy of such letter, the taxpayers acknowledged receipt of notice of the exercise of the option and approved the payment of the $69,412.50 to the title company. Accordingly, on the same day Buckbee Thorne endorsed the check and returned it to the title company. (IB-R. 151-152; Ex. 17-Q, IB-R. 99; see also Exs. 18-R, 19-S, IB-R. 100-101.)

Between December 19, 1957 and January 8, 1958, each of the twelve owners of the Sharon Building executed a grant deed conveying his interest in the Sharon Building to the taxpayers. These deeds were delivered to the title company on January 16, 1958, and were enclosed in a letter of escrow instructions by Hurford C. Sharon, acting as agent for the various owners of the Sharon Building, wherein the title company was authorized to deliver the deeds to the taxpayers when the title company received $1,150,000 for the account of the Sharons. Such letter also contained the following (IB-R. 152; Ex. 21-U, IB-R. 104-108):

> It is understood that $400,000.00 of such sum is to be received by you from the Rogers and $750,000.00 is to be received by you from a purchaser of * * * [description of 571 Market Street], which property is hereinafter referred to as the "Exchange Property". It is understood that Rogers will convey to you on behalf of the Owners [Sharon interests], the Exchange Property, in addition to the payment of said sum of $400,000.00. You are hereby authorized to execute a deed of the Exchange Property on behalf of the Owners [Sharons] conveying said property to Standard Oil Company of California the present holder of an option to purchase the Exchange Property, or its order, and you are further authorized to deliver said deed to said grantee when you hold said sum of $750,000.00 heretofore mentioned for the account of the Owners [Sharons].

On the same date the above instructions were amended to authorize the delivery of the deeds to the taxpayers upon the receipt by the title company for the account of the Sharons of $1,118,750 ($368,750 from the taxpayers and $750,000 from Standard Oil), instead of $1,150,000 the difference of $31,250 representing commission of Coldwell, Banker & Company for arranging the transaction. On the same date Hurford C. Sharon issued supplemental instructions to the title company to release

the sum of $21,250 out of funds deposited by Standard Oil 4/ to satisfy the demand of Buckbee Thorne, and also to prorate rent and insurance credited on the Market Street property and pay it to the ultimate purchaser, Standard Oil. (IB-R. 153; Exs. 22-V, 23-W, IB-R. 109-111.)

On January 16, 1958, the taxpayers deposited with the title company a deed of trust in the amount of $550,000 covering the Sharon Building, as security for the Aetna Life Insurance Company loan of $550,000 to the taxpayers. (IB-R. 153; Exs. 24-X, 25-Y, IB-R. 112-118.)

On January 16, 1958, the title company recorded the deeds transferring the Sharon Building to the taxpayers, and the taxpayers' deed conveying 571 Market Street to the title company. On the same date, the taxpayers notified the tenant of 571 Market Street to pay all future rentals to the title company. (IB-R. 153; Ex. 33-GG, IB-R. 134.)

On January 20, 1958, the title company sent to the manager of the office buildings department of Standard Oil a letter in which it was stated that on January 16, 1958, it had recorded, for the account of Standard Oil, the deed from the taxpayers to it covering 571 Market Street. (IB-R. 153-154; Ex. 34-HH, IB-R. 135-137.)

On January 29, 1958, the title company sent a letter to Coldwell, Banker & Company stating that the Sharon Building was acquired by the taxpayers "in consideration of the sum of $400,000.00 and the exchange of Market Street property, which was sold in the same transaction, for a consideration of $750,000.00." (IB-R. 154; Ex. 35-II, IB-R. 138.)

4/ The amount deposited with the title company in escrow was actually $771,250, instead of $750,000. (IB-R. 153.)

On January 31, 1958, the title company executed one grant deed conveying to Standard Oil the five parcels of property, including 571 Market Street, and such deed was recorded on that date. On the same date the title company assigned the lease of 571 Market Street to Standard Oil and notified the tenant to pay all future rentals to Standard Oil. The delay in transferring the properties to Standard Oil was due to difficulty encountered by the title company in clearing title to some of the property which was to be included, along with 571 Market Street, in a single deed to Standard Oil. (IB-R. 154; Exs. 36-JJ, 37-KK, IB-R. 139-140.)

The taxpayers had collected the rental on 571 Market Street for the full month of January, 1958 in the amount of $4,583.33. Of this amount they retained $2,291.67, representing the amount allocable to the period from January 1 to January 16. The remainder was not received by the Sharon interests but was paid to Standard Oil. (IB-R. 154.)

After the taxpayers acquired the Sharon Building they held it for the income derived from rents and profits. (IB-R. 154.)

On their federal income tax return for the taxable year 1958 the taxpayers reported the above transaction as follows (IB-R. 155; Ex. 1-A, IA-R. 33):

> On January 16, 1958, the taxpayers exchanged a building at 571 Market Street, San Francisco, for the Sharon Building, located at 39-61 New Montgomery Street, San Francisco. The exchange was as follows:

Value of property acquired:

Land (4/15 per appraisal)	$306,666.67	
Building (11/15 per appraisal)	843,333.33	$1,150,000.00
Less liabilities assumed		550,000.00
		$ 600,000.00

Cost of property given up:

Building	$194,000.00		
Less depreciation	13,580.00		
	$180,420.00		
Land	129,463.50	$309,883.50	
Less liabilities transferred		148,500.00	161,383.50
			$ 438,616.50
Expenses of exchange - net			20,011.43
UNRECOGNIZED GAIN			$ 418,605.07

In accordance with Section 1031 of the Internal Revenue Code, the gain is not recognized.

In the notice of deficiency the Commissioner determined that he gain realized should be recognized, stating (IB-R. 155-156; IA-R. 9):

> It is determined that you realized a long-term capital gain in the amount of $439,265.85 resulting from the sale of the real estate known as 571 Market Street, San Francisco, California. Such gain is taken into account to the extent of 50%, or $219,632.92, in computing taxable income. The gain is computed as follows:

Sales price	$771,250.00
Expense of sale	22,100.65
Net	$749,149.35
Basis per return	309,883.50
Gain on sale	$439,265.85

The Tax Court, noting that the escrow instructions of the Sharon nterests to the title company provided that the deeds for the Sharon uilding were to be delivered to the taxpayers only when the title company

had received for the Sharons the proceeds from the taxpayer and Standard Oil for the Sharon Building (IB-R. 160) and that by the time that the Sharon interests delivered deeds to the Sharon Building to the title company on January 16, 1957, it was "impossible for the Sharons to obtain any ownership of 571 Market Street since the * * * [taxpayers] had already effectively disposed of that property to Standard Oil" (IB-R. 162) pursuant to the option exercised by Standard Oil on December 19, 1957 (IB-R. 160), found and held that the taxpayers (IB-R. 163)--

> sold 571 Market Street to Standard Oil pursuant to the option, that the proceeds therefrom were used by them to purchase the Sharon Building, and that there was not an exchange by the * * * [taxpayers] of 571 Market Street for the Sharon Building.

Accordingly, it sustained the Commissioner's determination "that the transactions by which the * * * [taxpayers] disposed of 571 Market Street and acquired the Sharon Building do not qualify as an exchange under the nonrecognition provisions of section 1031 of the Internal Revenue Code of 1954" (IB-R. 157) and, therefore, the gain realized by the taxpayers "upon the disposition * * * of 571 Market Street is to be recognized" (IB-R. 164) under Section 1002 of the 1954 Code.

SUMMARY OF ARGUMENT

Section 1031(a) of the Internal Revenue of 1954 provides that no gain or loss shall be recognized upon an exchange of like kind properties That provision, as its terms and its legislative history make clear, does not apply where a taxpayer sells property and thus realizes cash gains (or losses), whether or not he reinvests the proceeds in other property. Congress has deliberately and wisely limited Section 1031 to exchanges, and effect must be given to that limitation.

In the instant case, the taxpayers sold 571 Market Street to Standard Oil and thus realized cash proceeds which they used to purchase the Sharon Building. Accordingly, there was no exchange of like kind properties but, instead, a sale and a reinvestment.

Further, arguendo, any exchange which occurred was not one of "like kind" properties within the meaning of Section 1031(a). Here, after the purchase option was exercised in December, 1957, the taxpayers held only a vendor's bare legal title to 571 Market Street plus their contractual rights to the sales proceeds. It follows that, even if, arguendo, they still held that vendor's title on January 16, 1958, when the alleged exchange took place, they could not then have possibly conveyed 571 Market Street--as like kind investment property--to the Sharons. Indeed, in Commissioner v. P. G. Lake, Inc., 356 U. S. 260 (1958), rehearing denied, 356 U. S. 964, the Supreme Court held that a contractual right to receive cash cannot be like kind property within the meaning of Section 1031(a).

Moreover, the facts show that the Sharons were unwilling to acquire 571 Market Street, subject to the unexercised option and, therefore, committed themselves to convey the Sharon Building to the taxpayers only upon receipt of the sales proceeds therefor. In other words, they sold their building to the taxpayers for cash and never acquired the taxpayers' property in exchange.

In the light of the foregoing, the Tax Court was correct in holding that the references in the escrow instructions to a deed to 571 Market Street being conveyed on behalf of and to the order of the

Sharons were mere formalities which did not reflect the substance of the transaction. But, even if, arguendo, those references were given effect, no transfer of a vendor's bare legal title (which, for reasons already stated, does not qualify as like kind property) could have taken place because the conditions of the sales contract between Standard Oil and the taxpayers had been satisfied and thus legal title had vested in Standard Oil prior to January 16, 1958, when the alleged exchange took place.

ARGUMENT

SINCE THE TAXPAYERS DID NOT EXCHANGE THEIR PROPERTY FOR LIKE PROPERTY, SECTION 1031 OF THE INTERNAL REVENUE CODE OF 1954 IS INAPPLICABLE, AND THE GAIN REALIZED BY THEM ON THE DISPOSITION OF THEIR PROPERTY MUST BE RECOGNIZED

A. Introduction

Standard Oil, an undisclosed principal acting through Buckbee Thorne as its agent, and using the services of the title company, as escrow holder, sought a site for an office building, including 571 Market Street owned by the taxpayers. (IB-R. 146; IA-R. 19.) On August 22, 1957, the taxpayers granted Standard Oil (still undisclosed) an option to purchase 571 Market Street for a net price of $750,000. (IB-R. 146-147; II-R. 19-22; Exs. 4-D - 6-F, IB-R. 75-78.) On December 19, 1957, two days after the taxpayers transferred a deed to their property to the escrow holder, the option was exercised, the requisite down payment was made and the balance of the purchase price was paid to the escrow holder. On the next day, the taxpayers were so advised and on

December 23, 1957, they acknowledged receipt of the down payment. (IB-R. 150-152; II-R. 39-41, 53-56, 58-59, 61-67; Exs. 12-L, 14-N, 16-P, 17-Q, 34-HH, IB-R. 86, 89-96, 98-99, 135-137; see also Exs. 26-Z - 28-BB, IB-R. 119-122.) On January 31, 1958, after a delay caused by certain apparently technical difficulties involved in obtaining clear title to some of the parcels included in the site, a single deed for the entire site (as Standard Oil had requested), including 571 Market Street, was transferred directly from the title company to Standard Oil. (IB-R. 154; II-R. 61-67, 73, 85; Exs. 36-JJ, 37-KK, IB-R. 139-140.)

In the meantime, in mid-September, 1957, the taxpayers' property manager, Coldwell, Banker & Company, acting on behalf of the Sharon interests, had approached the taxpayers with the suggestion that they acquire the Sharon Building with the proceeds from the then-pending sale of 571 Market Street. The taxpayers indicated that they would be interested in exchanging their property, subject to the purchase option, for the Sharon Building, and a valuation of that building was made for that purpose. (IB-R. 147-148; II-R. 22-27.) In early December, the taxpayers--but no other party--executed a so-called exchange agreement which recited, inter alia, that the Sharons would receive 571 Market Street subject to the option; a second escrow was then opened with the title company and the taxpayers notified the title company that they had agreed to an exchange. (IB-R. 148-149; II-R. 27-34, 50-51; Ex. 8-H, IB-R. 80-81; Ex. 39, IB-R. 142-143.) On December 17, 1957, when the taxpayers delivered their deed to the title

company, they instructed it, as escrow holder, to deliver that deed "to the order of Hurford C. Sharon, et al" at such time as title to the Sharon Building vested in the taxpayers and the taxpayers' $550,000 note and loan proceeds were in the possession of the title company. The title company was further instructed to use the loan proceeds to pay off a mortgage indebtedness on 571 Market Street, and to pay Hurford C. Sharon, et al., $368,750. (IB-R. 150; II-R. 35-38, 40, 42-46, 58-59; Ex. 13-M, IB-R. 87-88.) On January 16, 1958, the Sharons delivered deeds to the Sharon Building to the title company with their instructions to it, as escrow holder, that, inter alia, the deeds should be delivered to the taxpayers only when the title company was in receipt of the proceeds owed to the Sharons for the Sharon Building, which would be paid by the taxpayers and by Standard Oil (for 571 Market Street). Those instructions further authorized the title company to transfer a deed to 571 Market Street to Standard Oil on behalf of the Sharon interests when the title company held the proceeds for that property on behalf of the Sharon interests. (IB-R. 152-153; Exs. 21-U, 22-V, IB-R. 104-110.)

The taxpayers realized a gain of over $400,000 upon the disposition of 571 Market Street. (IB-R. 155-156.) The question before this Court is whether that gain is to be recognized and thus taxed in the year 1958 as long term capital gain or, instead, is to be recognized only when (and if) the taxpayers dispose of the Sharon Building in a taxable transaction.

Under Sections 1001 and 1002 of the Internal Revenue Code of 1954, supra, [5] gain or loss realized upon the disposition of property--whether a sale or an exchange--is usually recognized. An exception to that general rule is provided by Section 1031(a), supra, as follows:

> (a) * * * No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including * * * choses in action, * * * or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment. [6]

The taxpayers contend that either: (1) they exchanged their property for the Sharon Building or (2), there was a simultaneous sale of their property and a purchase of the Sharon Building which had the net effect of an exchange, and that--in either event--the transaction is encompassed by Section 1031(a). We contend that there was not an exchange but, instead, a contemporaneous sale and purchase of the two properties and that Section 1031, supra, does not apply to such transactions. We further contend that, in any event, because of the purchase option which had been previously exercised by Standard Oil, the taxpayer did not have "like" kind property within the meaning of Section 1031(a) to exchange for the Sharon Building (or to sell) but, instead, had only a chose in action--whether or not coupled with legal

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5/ Hereafter, except as otherwise indicated all references to sections are to the Internal Revenue Code of 1954.

6/ Under Section 1031(d), supra, where Section 1031(a) applies, a taxpayer's basis for the property he has exchanged is carried over to his newly acquired property. It is thus possible for the non-recognized gain to be taxed in the future if and when the newly acquired property is disposed of in a taxable transaction.

title to the property--to transfer to the Sharons and that Section 1031(a) does not apply to such property.

B. Since Congress has deliberately limited the application of Section 1031 to exchanges of like kind property, that provision does not apply where a taxpayer sells property and immediately reinvests in similar property

Fundamental to our contentions, outlined above, is our position that there is no "exchange" within the meaning of Section 1031 where a taxpayer sells property--thus significantly realizing gains in the sense of converting his investment or business property into the right to receive cash proceeds therefor--and immediately reinvests those proceeds (or the right thereto) into other similar property. In enacting Section 1031, Congress carefully distinguished between gains or losses realized upon a sale--regardless of any contemporaneous reinvestment--and the theoretical gains or losses realized upon direct exchanges, by deliberately restricting the non-recognition rule of Section 1031 to exchanges. "'Exchange' is a word of precise import, meaning the giving of one thing for another * * * and excluding transactions into which money enters * * * as the consideration * * *." Trenton Cotton Oil Co. v. Commissioner, 147 F. 2d 33, 36 (C. A. 6th, 1945); see also Jordan Marsh Co. v. Commissioner, 269 F. 2d 453, 457 (C. A. 2d, 1959).

In harmony with this concept of taxing realized cash-like gains, under the initial nontaxable exchange provision, Section 202(c) of the Revenue Act of 1921, c. 136, 42 Stat. 227, gain was recognized upon an exchange of property if the property received had a "readily realizable

fair market value". Because that terminology, however, proved to be too vague and indefinite to be workable, the "like kind" test was adopted as a refinement in Section 203(b)(1) of the Revenue Act of 1924, c. 234, 43 Stat. 253, and has been subsequently retained in the statute by re-enactment in successive Revenue Acts.[7/] See Jordan Marsh Co. v. Commissioner, supra, pp. 455-456. In 1924, when Section 203(b)(1) of the 1924 Act was presented to Congress, the question whether a sale and a contemporaneous reinvestment in like kind property would qualify as a nontaxable exchange was answered in the following colloquy in the House between one of the sponsors of the bill and another Representative (65 Cong. Record, Part 3, p. 2799):

> Mr. LaGuardia. Under this paragraph is it necessary to exchange the property? Suppose the property is sold and other property immediately acquired for the same business. Would that be a gain or loss, assuming there is greater value in the property acquired?
>
> * * * *
>
> Mr. Green of Iowa. If the property is reduced to cash and there is a gain, of course it will be taxed.
>
> Mr. LaGuardia. Suppose that cash is immediately put back into the property, into the business?
>
> Mr. Green of Iowa. That would not make any difference.

7/ See Section 203(b)(1), Revenue Act of 1926, c. 27, 44 Stat. 9; Section 112(b)(1), Revenue Act of 1928, c. 852, 45 Stat. 791; Section 112(b)(1), Revenue Act of 1932, c. 209, 47 Stat. 169; Section 112(b)(1), Revenue Act of 1934, c. 277, 48 Stat. 680; Section 112(b)(1), Revenue Act of 1936, c. 690, 49 Stat. 1648; Section 112(b)(1), Revenue Act of 1938, c. 289, 52 Stat. 447; Internal Revenue Code of 1939, Section 112(b)(1) (26 U.S.C. 1952 ed., Section 112(b)(1)).

As explained by the House Ways and Means Committee in 1934 (H. Rep. No. 704, 73d Cong., 2d Sess., p. 13 (1939-1 Cum. Bull. (Part 2) 554, 564), gain (or loss) is to be recognized when it is represented by property "essentially like money; * * *. The calculation of the profit or loss is deferred [only] until it is realized in cash, marketable securities, or other property not of the same kind having a fair market value".

After extensively reviewing the legislative history of the statute, the Second Circuit, in the Jordan Marsh Company case, explained its purpose and operation as follows (269 F. 2d, p. 456):

> Congress was primarily concerned with the inequity, in the case of an exchange, of forcing a taxpayer to recognize a paper gain which was still tied up in a continuing investment of the same sort. * * * These considerations, rather than concern for the difficulty of the administrative task of making the valuations necessary to compute gains and losses, were at the root of the Congressional purpose * * *.
>
> That such indeed was the legislative objective is supported by Portland Oil Co. v. Commissioner of Internal Revenue, 1 Cir., 109 F. 2d 479. There Judge Magruder, in speaking of a cognate provision contained in § 112(b), said at page 488:
>
> > "It is the purpose of Section 112 (b) (5) to save the taxpayer from an immediate recognition of a gain, or to intermit the claim of a loss, in certain transactions where gain or loss may have accrued in a constitutional sense, but where in a popular and economic sense there has been a mere change in the form of ownership and the taxpayer has not really 'cashed in' on the theoretical gain, or closed out a losing venture." (All emphasis supplied.) (Footnote omitted.)

But in the instant case, by reason of the sales transaction with Standard Oil, the taxpayers' "capital invested in the real estate involved had been completely liquidated for cash to an amount equal to the value of the fee. This * * * was a sale" (Jordan Marsh Co. v. Commissioner, supra, p. 456).

While, as the taxpayers point out (Br. 28-32), a contemporaneous sale and reinvestment leaves a taxpayer (but not the buyer) in essentially the same economic position as does a direct exchange--in the sense that after they occur he still has his capital invested in the same type of property as he did before--that is only one of the effects of an exchange.[8/] The taxpayers' argument fails to grasp the fundamental and controlling principle that once a sale is effected and cash-like gains thus realized, the underlying justification and rationale for not recognizing gains--upon the non-cash conversion of similar property investments--is inapplicable. Once a sale is effected and a cash gain thus realized, a contemporaneous purchase of similar property--whether or not conducted through a common broker--does not qualify the two transactions as a nontaxable exchange under Section 1031. Coastal Terminals, Inc. v. United States, 320 F. 2d 333, 337 (C. A. 4th, 1963); Trenton Cotton Oil Co. v. Commissioner, supra, p. 36; Jordan Marsh Co. v. Commissioner, supra, p. 455. Here, the taxpayers--or the title company on their behalf--received from Standard Oil the equivalent of cash or the right thereto, over which they had dominion and control, pursuant to the sales transaction with Standard Oil.

8/ In a qualifying exchange however, the net effect is necessarily the same for both parties to the transaction. That is, if "like kind" properties are exchanged, both parties hold property immediately after the transaction similar to that which they held prior thereto. As hereafter more fully explained, that was not the situation here, because the Sharons neither held nor had the right to hold 571 Market Street for any purpose--not even momentarily. Instead, all they obtained was the right to receive the proceeds for the Sharon Building upon its sale.

Contrary to the taxpayers' argument (Br. 29), in a qualifying exchange transaction the taxpayers would have no such sales proceeds to use and control in order to effect a contemporaneous purchase of other property. When the taxpayers used these amounts thus received, or the right thereto to acquire the Sharon Building, they in effect made an anticipatory assignment of income (here capital gains) already realized in cash or its equivalent from the sale of 571 Market Street. In no way were they effecting an exchange of like kind properties within the meaning of Section 1031(a). Commissioner v. P. G. Lake, Inc., 356 U. S. 260, 263-264, 267-268 (1958), rehearing denied, 356 U. S. 964.

The purpose and necessity of restricting Section 1031 to direct exchanges are clear. Direct exchanges of similar properties, unlike sales transactions, do not yield cash proceeds (or the right thereto). Neither do they result--in any significant sense--in losses. See Jordan Marsh Co. v. Commissioner, supra, p. 456. Further, since the recipient of a taxpayer's property in an exchange transaction has to have like kind property with which to effect the exchange, direct exchanges are sufficiently rare that Section 1031 probably does not result in so many instances of tax deferral (or avoidance) as to create a serious erosion of the capital gains tax base. By contrast, in a sales transaction (whether or not accompanied by a reinvestment) a taxpayer-seller has the right to receive cash and thus realizes gain (or loss) in a significant, practical sense (which he may use to acquire other property). Further, sales and contemporaneous purchases of similar property are easily arranged--whether or not through a common broker or escrow holder--and are certainly not uncommon. If Section 1031, then--contrary to the meani

of "exchange" therein as shown by its legislative history and as consistently interpreted by the courts--were construed to apply to sale-reinvestment transactions, capital would be readily pyramided without the payment of any capital gains tax on significantly realized gains by those fortunate enough to be able to sell and immediately reinvest the proceeds (and other funds) in similar investment properties.[9/] That result was not what Congress either intended or provided for when, in enacting Section 1031 (and its predecessors), it restricted the non-recognition of gains or losses to those incurred upon exchanges.

The strict exchange requirement of Section 1031, which encompasses voluntary transactions covering a wide variety of like kind business and investment properties, is to be contrasted with the more liberal sale-reinvestment or exchange provisions of Section 1034, which applies only to residential properties, and of Section 1033, which applies only to involuntary conversions. Under Section 1034, gain is not recognized either upon a sale of residential property where the similar property is purchased within one year or upon the exchange of such properties. Similarly, under Section 1033(b), gain is not recognized upon the "sale [and subsequent replacement] or exchange of such property under threat or imminence of requisition or condemnation". Congress,

9/ The unrecognized gains will be recognized only if and when the properties acquired are disposed of in a taxable transaction. See Section 1031(d) and fn. 6, supra. Where, however, such properties are not so disposed of before death, the estate or heir takes as their bases for such properties their then fair market value. Section 1014(a). Accordingly, in that event it is possible that taxes on the unrecognized gains will be avoided altogether.

then, in Sections 1033 and 1034, has carefully selected those particular instances where gain will not be recognized upon a sale and reinvestment of the proceeds in similar property. Both of those provisions are of specifically limited application and each of them covers situations where practical necessity and specific policy considerations justify the non-recognition of gains upon sale-reinvestmen transactions. By contrast, under Section 1031, because of the frequent and general application of that provision--in terms of the types of property covered in voluntary transactions--any relaxation of the exchange requirement would result in great tax deferrals (or avoidance) on cash gains which would be entirely unjustified.

In the circumstances, effect should be given to the language deliberately chosen by Congress. This means that the concept of an exchange should not be strained or especially expanded to include a sales transaction coupled with a reinvestment in similar property. See Commissioner v. Brown, 380 U. S. 563, 571 (1965), affirming 325 F. 2d 313 (C. A. 9th, 1963); Hanover Bank v. Commissioner, 369 U. S. 672, 687-688 (1962); Helvering v. Rebsamen Motors, 128 F. 2d 584, 587-588 (C. A. 8th, 1942).

C. Since the taxpayers sold their property pursuant to the option, and, moreover, since the Sharons were unwilling to acquire that property in exchange for their building, there was no exchange of properties but, instead, a sale and purchase

From the outset here, the taxpayers--considering the advantageous price offered to them by Standard Oil 10/ for 571 Market Street--decided that they were willing to sell at that price and, by granting Standard Oil a purchase option to accomplish that objective, committed themselves to selling that property to Standard Oil upon the exercise of the option. (IB-R. 146-147; II-R. 20-21; Ex. 4-D, IB-R. 75-76.) That option agreement unqualifiedly gave Standard Oil the right to purchase the taxpayer's property. Under that option Standard Oil did not have to agree--and in fact did not agree--to any exchange transaction in order to acquire the property from the taxpayers. Once Standard Oil exercised the option according to its terms on December 19, 1957, it was committed to purchasing the property (subject only to the condition of non-objectionable title as set forth in the option) and a contract of sale was thus created, giving Standard Oil the remedy of specific performance. E.g., see Caras v. Parker, 149 Cal. App. 2d 621, 626-627, 309 P. 2d 104, 107-108 (1957); see also Commissioner v. Brown, 380 U. S., pp. 570-571.

10/ While the option was granted to the title company on behalf of Standard Oil as undisclosed principal, hereafter for clarity reference is made directly to the principals to these transactions except where the context requires reference to the title company or Buckbee Thorne.

Accordingly, after December 19, 1957, the taxpayers, as they now apparently agree (Br. 19-21) held only a vendor's title to 571 Market Street, which was subject to immediate divestment upon performance of the conditions of the sales contract between the taxpayers and Standard Oil, [11] coupled with a contractual right to receive the sales proceeds for the property from Standard Oil. It follows that, as the Tax Court held, by the time that the Sharons delivered their deeds to their building, along with their instructions, in escrow on January 16, 1958 (before which certainly no exchange had occurred) "it was impossible for the Sharons to obtain any ownership of 571 Market Street since the * * * [taxpayers] had already effectively disposed of that property to Standard Oil". (IB-R. 162.)

Further, the Sharons never intended to acquire 571 Market Street and thus effect the alleged exchange. Instead, they intended to sell their property for cash and that is all they ever agreed to.

Contrary to the taxpayer's argument (Br. 15) the taxpayers and Sharons never agreed in early December, 1957 (or at any other time) to exchange 571 Market Street, subject to the then unexercised purchase option, for the Sharon Building. While the taxpayers executed such a proposed agreement, the Sharons failed to sign it. (IB-R. 148-149, 158-159; Ex. 39, IB-R. 142-143; see also II-R. 27-33). Their reason for failing to sign it is clear. As the Sharons' subsequent escrow instructions of January 16, 1958 show, they were unwilling to receive 57

11/ See Shreeves v. Pearson, 194 Cal. 699, 707, 230 Pac. 448, 451 (1924) Todd v. Vestermark, 145 Cal. App. 2d 374, 377, 302 P. 2d 347, 349 (1956); see generally, Pederson, Escrows--Defalcation of Escrow Holder--Allocation of Loss to Vendor or Vendee--Agency and Trust Theories, 31 Or. L. Rev. 218 (April, 1952).

Market Street subject to the unexercised option (plus cash) in exchange for their building, and never intended to and never did enter into such an agreement. As disclosed by their initial approach to the taxpayers (II-R. 23-26), the Sharons wanted to sell the Sharon Building for cash and their escrow instructions carried out that intention. Those instructions, which, coupled with the taxpayers' instructions, embodied the only agreement ever made between the parties (Caras v. Parker, 149 Cal. App. 2d. 621, 626-627, 309 P. 2d 104, 107-108 (1957); see IB-R. 158-159) make no mention of any such exchange subject to an unexercised option. Instead, those instructions unequivocally provide, inter alia, that a conveyance of the Sharon Building was to be made to the taxpayers only after Standard Oil had purchased 571 Market Street by exercising its option and had paid into escrow the sales proceeds therefor and after the taxpayer had paid into escrow an additional $368,750 for the Sharon Building. (Exs. 21-U, 22-V, IB-R. 104-110.)[12/] In other words, the

12/ Those instructions provided, inter alia (Ex. 21-U, IB-R. 104-105, as modified by Ex. 22-V, IB-R. 109):

> The Agent hereby authorizes you to deliver the deeds constituting Enclosure "A" to John M. Rogers and Gladys B. Rogers, his wife, hereinafter referred to as the "Rogers," upon the following terms and conditions:
>
> 1. When you hold for the account of the Owners the sum of * * * [$1,118,750] together with such additional sums which may be due the Owners as set forth below, less any amounts which you are directed to withhold from said sum as set forth below.

(continued on next page)

Sharons committed themselves to conveying their building only upon the receipt of cash therefor, as distinguished from committing themselves to conveying their building in exchange for 571 Market Street (plus cash). (IB-R. 160.) Such a conveyance for all cash is a sale, not an exchange. Trenton Cotton Oil Co. v. Commissioner, 147 F. 2d p. 36; see Commissioner v. Brown, 380 U. S., pp. 570-571. It follows that the Tax Court was correct in holding that the taxpayers did not convey 571 Market Street to the Sharons and that their escrow instructions--and those of the Sharons--in authorizing a deed to 571 Market Street to be delivered to the order of the Sharons and on their order to Standard Oil "were mere formal matters which do not reflect the substance of the transaction, as pointed out hereinabove". (IB-R. 162.)

Indeed, on January 31, 1958, the title company--carrying out its prior obligations pursuant to the contract of sale and the instructions it had received from Standard Oil (Exs. 4-D, 14-N, IB-R. 75-76, 89-96) formally conveyed title to 571 Market Street directly from itself to Standard Oil (IB-R. 154; Ex. 36-JJ, IB-R. 139). Since the taxpayers

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(Footnote 12 continued)--

> 2. It is understood that * * * [$368,750] of such sum is to be received by you from the Rogers and $750,000.00 is to be received by you from a purchaser of the parcel of real property situated in the City and County of San Francisco and more particularly described as follows:
>
> * * * [Description omitted]

have never challenged that conveyance, they must be deemed to have ratified it as correctly reflecting the substance of the transaction between themselves and Standard Oil.[13/]

In summation of this point, the Sharons were unwilling to agree and never agreed to receive 571 Market Street (plus cash)--instead of cash--in exchange for their building. Further, even if it be assumed, arguendo, that the taxpayers still held a vendor's title to 571 Market Street on January 16, 1958, to convey to the Sharons, the substance of their agreement did not involve any such transfer, or any type of an exchange of the two properties.

D. In any event, since the taxpayers had effectively disposed of their building--as like kind investment property--pursuant to the option, they could not possibly have effected an exchange of like kind property with the Sharons

The taxpayers argue (Br. 19-20, 22) that on January 16, 1958, they held a vendor's title to the property, subject to the sales contract between Standard Oil and themselves, and that pursuant to the escrow instructions that title was conveyed to the Sharons. As stated in Part C, supra, that aspect of the escrow instructions does not reflect the substance of the transaction between the taxpayers and the Sharons. But, assuming, arguendo, both that: (1) the directions in the escrow instructions to convey title to 571 Market Street to the order of the

13/ As explained in Part D, infra, title to 571 Market Street actually vested in Standard Oil much earlier than January 31, 1958, and, in all probability, prior to January 16, 1958.

Sharons and on their order to Standard Oil (Exs. 13-M, 21-U, 22-V, IB-R. 87-88, 104-110) are to be taken at face value and (2) the taxpayers still held a vendor's title on January 16, 1958, any such exchange would not be covered by Section 1031(a). In that event, the taxpayers could convey only a vendor's title, subject to divestment upon the performance of the conditions of the sales contract between Standard Oil and the taxpayers, and their contractual right to receive the sales proceeds for their property from Standard Oil. That contractual right, the valuable property right to be granted to the Sharons in exchange for their building, was a chose in action, not investment property.[14/] Such a contractual right to cash cannot qualify as like kind property under Section 1031(a). Commissioner v. P. G. Lake Inc., 356 U. S. 260, 263-264, 267-268 (1958), rehearing denied, 356 U. S 964.

Moreover, legal title to 571 Market Street vested in Standard Oil, directly from the title company, as escrow holder when the condition of the sales contract--as set out in the option (Ex. 4-D, IB-R. 75-76), and reflected in Standard Oil's instructions to the title company (Ex. 14-N, par. 3, IB-R. 91-93) (namely, a determination by that company that title to the property was non-objectionable)--was satisfied. When that condition was satisfied then the title company became the agent of each party "in respect to those things placed in escrow to which each

14/ There is no question but that such a contractual right can be assigned. See Mutual Benefit Life Ins. Co. v. Clark, 81 Cal. App. 546, 553, 254 Pac. 306, 309 (1927); W. H. Marston Co. v. Fisheries Co., 201 Cal. 715, 723, 258 Pac. 933, 936 (1927).

has become completely entitled. * * * he thereupon becomes the agent of the purchaser as to such deed and of the seller as to such [purchase] money" (Shreeves v. Pearson, 194 Cal. 699, 707, 230 Pac. 448, 451 (1924)) and "title passes eo instanti" (Todd v. Vestermark, 145 Cal. App. 2d 374, 377, 302 P. 2d 347, 349 (1956)).[15/] See generally, Pederson, Escrows--Defalcation of Escrow Holder--Allocation of Loss to Vendor or Vendee--Agency and Trust Theories, 31 Or. L. Rev. 218 (April, 1952). Here, as the Tax Court indicated (IB-R. 162, fn. 7), while the exact date that this condition was satisfied is not known, the evidence of record strongly suggests that that date was probably as early as January 2, 1958, and in any event, occurred before January 16, 1958, and that the formal closing "was deferred [either] to accommodate the sellers" (Ex. 32-FF, IB-R. 133; see also II-R. 46-47, 64-65) or for technical reasons until January 16, 1958 (II-R. 73; see also IB-R. 154). Accordingly, we contend that it was impossible for the taxpayers to effect any kind of any exchange, even one involving a vendor's bare legal title to 571 Market Street, which would not qualify as an exchange under Section 1031 in any event, with the Sharons on January 16, 1958. (See Br. 23, 26, 32, compare IB-R. 163-164.)

15/ The taxpayers had delivered a deed to the title company conveying 571 Market Street to that company on December 17, 1957. (IB-R. 150; Ex. 12-L, IB-R. 86.) Standard Oil delivered the balance of the entire purchase price money by check (less the previously paid option payment and down payment) to the title company in escrow on December 20, 1957. (IB-R. 151; IA-R. 22-23.)

The cases relied on by the taxpayers (Br. 23, 26, 32) are distinguishable on their facts from the instant case (see IB-R. 163-164. For example, in Alderson v. Commissioner, 317 F. 2d 790 (1963), this Court, in holding that the alleged exchange had occurred, relied extensively on the Tax Court's finding that Alloy, the other party to the transaction, actually acquired title to the exchange property (the Salinas property), albeit solely to effectuate the exchange that had been agreed upon. This Court held that this underlying purpose--with Alloy not acquiring a real interest in the property in the sense of actually intending to assume and assuming the benefits and burdens of ownership--did not disqualify the exchange, since in fact Alloy did become the owner of the property. If what was done, this Court reasoned aside from the purpose of avoiding tax, is encompassed by the statute, the transaction qualifies thereunder. See Alderson v. Commissioner, supra, pp. 793-794. To the same effect is Coastal Terminals, Inc. v. United States, 320 F. 2d 333 (1963), where the Fourth Circuit similarly made it clear (p. 336) that the findings of the trial court as to the passage of title and the presence or absence of an exchange are to be sustained unless clearly erroneous. Here, the Tax Court specifically found and held that the taxpayers never conveyed 571 Market Street to the Sharons and that the alleged exchange never occurred. In the light of the evidence of record, that holding is clearly correct.

As we stressed at the outset (Part B, supra), it must constantly be borne in mind that Section 1031 applies only to exchanges, and not to contemporaneous sales and purchases. Where two parties, both of whom

hold like kind properties with high basis and low fair market values, directly exchange their properties, their losses are essentially theoretical and no loss deductions are allowed pursuant to Section 1031. But once they realize a cash loss upon the disposition of their properties--just as the taxpayers here realized a cash gain on the sales transaction with Standard Oil--regardless of any simultaneous investment in similar property, the transaction must be recognized for tax purposes. See Jordan Marsh Co. v. Commissioner, 269 F. 2d 453, 455 (C. A. 2d, 1959); H. Rep. No. 704, 73d Cong., 2d Sess., p. 13 (1939-1 Cum. Bull. (Part 2), 554, 564).

CONCLUSION

For the reasons stated above, the decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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MAY, 1966.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: _____ day of _____, 1966.

_____
Edward Lee Rogers
Attorney